



**CITY OF SCOTTSDALE
AUDIT COMMITTEE**

MONDAY, JUNE 30, 2008

**KIVA CONFERENCE ROOM
3939 NORTH DRINKWATER BLVD.
SCOTTSDALE, AZ 85251**

PRESENT: Jim Lane, Committee Chairman
Wayne Ecton, Committee Member
Ron McCullagh, Committee Member (arrived 3:52 p.m.)

ALSO PRESENT: Brent Stockwell, City Auditor's Office
Joyce Gilbride, City Auditor's Office
Lisa Gurtler, City Auditor's Office
Susan English, City Auditor's Office
Paula Novacek, City Auditor's Office
Joanna Munar, City Auditor's Office
Debra Baird, Community Services
Scott McCarty, Financial Services
Craig Clifford, Financial Services
Carter Smitherman, Cronstrom, Osuch & Company
Craig Clifford, Financial Services

CALL TO ORDER/ROLL CALL

Chairman Lane called the Audit Committee meeting to order at 3:32 p.m. Roll call was taken confirming the presence of Committee Member Ecton and Chairman Lane. Committee Member McCullagh arrived at 3:52 p.m.

1. Approval of Minutes from the Regular Meeting on April 21, 2008.

Committee Member Ecton made a motion to approve the April 21, 2008, minutes. Chairman Lane seconded the motion. The minutes were approved by a unanimous vote of two (2) to zero (0).

2. Discussion with external auditors Cronstrom, Osuch & Company about implementation of new auditing standard regarding communication with those in governance

Representing Cronstrom, Osuch & Company, Carter Smitherman discussed new industry standards regarding external auditors' communications with those in governance. These communications will include information regarding the external auditors' responsibilities and what responsibilities still rest with City management.

The purpose of the external audit is to give an opinion as to whether the City's financial statements are fairly stated. An opinion is also given on compliance with major programs. Internal controls are evaluated for both the financial audit and the single audit for the purpose of assessing risk and where the audit should be concentrated; however, opinions on the internal controls structure are withheld.

Chairman Lane asked if an indication of reduced reliance on internal controls and an instance of expanded scope is reported to City governance. Mr. Smitherman stated if it is a minor operating deficiency the findings are presented to management. A significant deficiency or material weakness would be reported to the Committee. As part of the audit process and new audit requirements, the external auditors are required to gain an extremely in-depth understanding of the internal control structure and environment. Before they are even tested, the design of controls is evaluated for effectiveness. Internal controls still rest with management, as well as the responsibility of the fairness of the presentation of financial statements.

Mr. Smitherman highlighted required communications with City governance during the audit process:

- Significant difficulties encountered during the audit, including delays of management providing requested information.
- Unnecessarily brief time to complete the audit
- Uncorrected misstatements (limited to financial misstatements)
- Disagreements with management
- Management's consultation with other accountants

Mr. Smitherman noted that he does not anticipate having to come to the Committee with any of these items.

Chairman Lane pointed out some of this communication with governance is new, and asked if these communications were previously maintained between the audited entity and the external auditor. Mr. Smitherman agreed communication was mainly between management and the external auditors, and only went up to those charged with governance if management and the auditors could not agree. The new audit guidelines take it a step further and pass the information along to governance.

3. Discussion of draft Audit Report No. 0510D, Scottsdale Cultural Council Management Services Agreement - General and Financial Requirements

Auditor Joanna Munar presented the Committee with the fifth and last report for the audit of the Scottsdale Cultural Council's Management Services Agreement. The new agreement goes into effect on July 1, 2008.

Committee Member Ecton noted that contributed revenues have been fairly static, and said he hoped that number can go up significantly with new management and guidance. Chairman Lane noted that earned revenue has been dropping off a bit dramatically. Referencing a lawsuit from 2007, Chairman Lane asked whether the courts have provided a definition putting the Scottsdale Cultural Council (SCC) in the private organization category. Committee Member Ecton said the SCC has agreed to follow the spirit of the law as much as possible, but no specific definition was determined. They have open meetings and executive sessions; however, two items they will not disclose are information related to salaries and donor contributions. Chairman Lane expressed concern that they could be accused of not operating as a private entity. Financial Services General Manager Craig Clifford noted that the City was pushing to make their records and operations as open as possible. Acting City Auditor Brent Stockwell explained that the City is requiring a certain amount of openness that comes along with receiving funds from the City which would not be inherent in a private or non-profit organization otherwise. Committee Member Ecton said this is a part of their charter that they must deal with themselves. Chairman Lane agreed as long as the City audits them as a contractor, they are being treated as a private entity.

Committee Member Ecton said this was a very complex process and he is pleased with the result. Chairman Lane noted management responses on the findings were in total agreement.

Committee Member Ecton made a motion to accept as presented Audit Report No. 0510D, Scottsdale Cultural Council Management Services Agreement - General and Financial Requirements. Committee Member McCullagh seconded the motion, which was approved by a unanimous vote of three (3) to zero (0).

4. Discussion of draft Audit Report No. 0616, Voluntary Utility Billing Donation Program (Scottsdale Cares)

Committee Member McCullagh asked if this program was audited to determine how much of the gross revenues collected actually went into donations and how much did not. Assistant City Auditor Lisa Gurtler pointed out a list of donation recipient agencies listed on page four of the report. She indicated money donated but not used specifically toward donations is not addressed in the report. Mr. Clifford stated administrative and other costs are paid for out of a separate City budget. Mr. Stockwell pointed out none of the contracts caused concern about how the funds were used.

Chairman Lane asked if there is a direct tie with what is contributed to what is being allocated and funded. Community Services General Manager Debra Baird explained that the City would not award more than is received; however, historically there has always been more funds collected, which stays in the account until it is allocated by the City Council.

Chairman Lane asked if these funds are used to assist residents with paying their utility bills. Ms. Gurtler explained the majority of the funds help citizens pay emergency rent, mortgage, utilities, and food.

Committee Member Ecton made a motion to accept as presented Audit Report No. 0616, Voluntary Utility Billing Donation Program (Scottsdale Cares). Committee Member McCullagh seconded the motion, which was approved by a unanimous vote of three (3) to zero (0).

5. Discussion and review of termination of Audit No. 0615, Use of Outside Law Firms

Assistant City Auditor Joyce Gilbride said this was an item that was included on the 2006 Audit Plan and carried forward to 2007. After extensive preliminary survey work there have been no findings. No report has been prepared since the auditor who conducted this work is no longer with the City. Mr. Stockwell indicated former City Auditor Cheryl Dreska also did some additional work on this item, and he presented the Committee with a memorandum explaining that the policies and procedures were in place to terminate the audit, which is the Audit Department's recommendation.

Chairman Lane noted there was recently a change of procedures, and asked if there were procedures in place with control mechanisms before those changes took place. Ms. Gilbride indicated that was correct, and any violations of the previous procedures would have been noted.

Mr. Stockwell stated the audit's scope had been expanded and had already exceeded the hours allotted to it with no findings. The issue at this time is whether the Audit Department should expend its limited resources to check the work that has been done to produce a report that meets standards. If the Audit Committee determines the audit should go forward, it will be completed.

The Committee accepted the recommendation to terminate Audit 0615, Use of Outside Law Firms.

6. Staff update and discussion regarding status of current audits and special projects, including the Preserve Gateway fact-finding report

Ms. Gilbride updated the Committee on the status of audits currently underway.

The final report for the WestWorld Financial Operations Audit is currently being drafted. This will be issued for management review by August. The Basin Management Funds Audit draft report is currently out for management review, and an exit conference is scheduled for July 2nd. The draft report for the Fire Department Asset Management Audit is almost complete, and will be released for management review within two weeks. The Audit Department is entering the preliminary testing phase of the Workers' Compensation Audit, and we will be entering the preliminary testing phase of the audit. The Development and Permit Fees Audit will be entering the preliminary testing phase the week of July 7th.

Committee Member McCullagh asked for clarification regarding the Basin Management Funds. Ms. Gilbride explained they are three accounts the City has set up for maintaining the ticket surcharges at West World, and golf course surcharge fees for the TPC and Sanctuary.

Committee Member McCullagh asked if City employees collect the money or if vendors are hired who manage the parking at WestWorld. Ms. Gilbride clarified the Basin Management Funds Audit does not include parking; it encompasses event ticket surcharges based on the number of tickets sold for an event, or rounds of golf calculated by the management at TPC and Sanctuary each month.

Mr. Stockwell stated the Basin Management Funds Audit would come forward to the Committee in August, as well as each of the WestWorld financial agreements. The parking agreement is one part of the WestWorld audit.

Ms. Gurtler presented the Committee with an update of the Fact-Finding Report. The objective of the report is to study the circumstances and processes employed in acquiring the Gateway property within the Scottsdale Preserve. The scope of the study includes the prioritization of the purchase, risk assessments and conditions at the time; strategic, tactical, and financial pre-option agreements; and the actual acquisition process used for this particular piece of property.

Sources of information used to complete this study include all court depositions and testimony, personnel interviews, Council action reports, resolutions, City Code, and meeting minutes from the McDowell Sonoran Preserve Commission.

Ms. Gurtler reviewed the documentation obtained during the study, and indicated the fieldwork phase is approximately 85 percent complete. Critical to this phase of fieldwork is the auditors' understanding of the McDowell Sonoran Preserve and its mission. The report is approximately 15 percent complete, and will address key events impacting the outcome and the decisions made. It will include information regarding negotiations with Toll Brothers, decision and timing of the condemnation, compliance with applicable City procedures, prioritization of the property, the State Land auction process, and a recommendation section based on the findings.

Chairman Lane expressed concern regarding the documentation or the lack thereof, and whether it is supported by email or other correspondence or substantiated with documentation. He suggested those connections be made with regard to support of the Council reports. Ms. Gurtler explained the only limitation is that the Audit Department does not have access to Executive Session meeting minutes and contents; however, dates, times, and the subject matter of Executive Sessions will be noted. She stated that other than this limitation, she feels the auditors are finding sufficient documentation.

Chairman Lane asked if it fair to say that guidance given in Executive Sessions was appropriately acted upon. Ms. Gurtler replied while the auditors can tell that steps were taken, there is no way of knowing that was the information that was provided in an Executive Session. Mr. Stockwell indicated he has communicated with Acting City Manager John Little, the Mayor, and City Council asking them to provide any pertinent documentation relative to this acquisition outside of Executive Session.

Mr. Stockwell said the Audit Department is approximately 50 percent of the way through this process, and plans to release the report to the Mayor and Council when it is complete. In response to an inquiry by Chairman Lane, Mr. Stockwell stated he anticipates the report will be released in mid-August.

Committee Member McCullagh asked if the minutes of an Executive Session ever become public. Committee Member Ecton stated he believes they are never made public, and Committee Member McCullagh asked if the Council could request that they be made public. Mr. Stockwell said he believes the Council could make a determination to release documents presented in Executive Sessions, but not the actual contents of the Executive Session or minutes.

7. Staff updates, discussion and consideration of possible recommendations to the City Council regarding the proposed FY 2008/09 Audit Plan

Mr. Stockwell discussed the development of the 2008 Audit Plan, and presented a proposal to the Commission. The Audit Department intends to incorporate any Commission feedback into an action item for the City Council's July 8 agenda.

Mr. Stockwell noted there has been a gap between the number of audits proposed and the number of audits completed, and presented a plan he hopes will close the gap. While it is a reduced number of proposed audits from past years, as many audits should be completed within this fiscal year as have been completed in any of the prior six years.

The proposed plan includes 14 audits and 15 completed reports, including the Fact-Finding Report. Nine new audits are proposed for FY 2008/2009. Mr. Stockwell highlighted audits previously discussed by the Committee, as well as items included in the 2007/2008 Plan.

In the past, three standard compliance audits have been conducted on an annual basis: Cash Handling, Procurement Card, and Travel Expenditures. While there has been some discussion about eliminating them, staff felt they were valuable as training audits. Mr. Stockwell recommended conducting four random cash handling audits within the City this year, and doing the same with procurement card and travel expenditure audits in future years.

Given the current economic environment, an audit of City fuel usage may be prudent. The responsibility for fuel rests with the Municipal Services Department and Fleet Management. Chairman Lane noted an audit of fuel usage would center on Municipal Services and Fleet Management operations Citywide. Mr. Stockwell agreed, and added it would also look at how different departments were utilizing fuel. Chairman Lane asked for clarification on what the focus of this audit would be. Mr. Stockwell stated as well as auditing fuel purchased in bulk and distributed throughout the City, it would also include an audit of alternative fuel sources.

A follow-up of the Code Enforcement audit is suggested to test the results from the previous audit recommendations.

Water Resources has only been audited once in the past six years. The audit completed was a Water Conservation audit, a relatively small area within Water Resources.

Mr. Stockwell suggested a Water Systems Security audit to ensure compliance with the 2002 Bio-Terrorism Act. Chairman Lane noted there is currently a lot of emphasis on emergency preparedness. Mr. Stockwell said water system security would be audited, as well as how the City handles delinquent collections. There is currently approximately \$24.5 million in the City court, and an additional amount Citywide. The audit will cover both the City's and the Court's collection practices. Chairman Lane asked if the court system handles its own collections. Mr. Stockwell stated the City Court handles collections through a contractor. Since Citywide collections and court collections are two separate areas, it is possible this will result in two reports. Mr. Clifford indicated the court pursues active collections on cases with outstanding warrants to the extent they can, and those cases never go stale.

Mr. Stockwell stated Economic Vitality has been audited once in the last six years, and suggested an audit of the Scottsdale Convention and Visitors' Bureau (CVB) agreement. A performance audit provision is included within the agreement with the CVB. Committee Member Ecton asked if this audit would be considered a medium or large audit. Mr. Stockwell stated a medium-category audit would be a 350 to 650-hour audit, and the Audit Department anticipates it will fall within that range. Committee Member Ecton stated he believes it will fall into the category of a large audit, and suggested staff be flexible on this item.

A required independent evaluation of minimum accounting standards is due in the Spring of 2009.

The Audit Department is recommending a Use of Purchase Orders audit in the Purchasing Division, looking at the assessments that are made for the appropriate purchasing method. Committee Member Ecton asked if it makes sense that change orders and purchase orders are all part of the same audit. Mr. Stockwell said change orders relative to capital projects are a different issue than the use of purchase orders for procurement that is handled through Financial Services and the Purchasing Division. Changes to the change order process were implemented last year, which has seemed to have limited their number. Mr. Clifford said while they are related to purchase orders, they are unique to capital projects. Committee Member Ecton expressed concern regarding the quality of the original purchase orders on capital projects because so many change orders come through.

In regard to consideration of conducting an In-Lieu Parking audit, Committee Member McCullagh pointed out that the audit of in-lieu parking fees is not what the Committee originally suggested; rather, whether the structure of the in-lieu parking program was being adhered to by business owners. Chairman Lane agreed an element of the audit should include the number of spaces available, how they are allocated, and how they are purchased or leased; however, an accounting and allocation of the funds should also be considered. Committee Member McCullagh said he would like to encompass the administrative aspect of in-lieu parking into the audit, and would like to see it moved onto the audit list for this coming year. Chairman Lane stated staff has tried to trim the list down to make completion more realistic.

Committee Member Ecton said he has the same concerns as Committee Member McCullagh; however, another audit would have to be removed from the list to accomplish this audit. He indicated he has been assured many times that the

Transportation Department audits in-lieu parking on a regular basis to make sure that the leases are still in force.

Mr. Stockwell said that given the size of the recommended audits and the staff available, he would recommend removing either the Use of Purchase Orders or City Fuel Usage audit in order to accommodate an In-Lieu Parking audit. Chairman Lane stated he would like to see the City Fuel Usage audit remain on the list.

Committee Member McCullagh said he would agree with moving the Use of Purchase Orders off of the list for the year and replace it with the In-Lieu Parking audit. Committee Member Ecton said although he is concerned about the parking, he would leave the list the way it is since the Use of Purchase Orders audit is a higher priority.

Chairman Lane asked if the use of purchase orders has been audited recently, and Mr. Clifford clarified that he recommended the Use of Purchase Orders audit be included on the list. He suggested building a contingency list from the list of audits considered but not recommended at this time, in the event time allows for another audit. Mr. Stockwell noted that the Audit Plan can be revisited throughout the year should conditions or priorities change.

Committee Member McCullagh reiterated he would like to see the In-Lieu parking audit moved up into this year's schedule. Mr. Stockwell said the Committee would need to agree to replace the Use of Purchase Orders audit in order to include it.

The Committee agreed that Mr. Stockwell will include language in the Council Action Report identifying the In-Lieu Parking and Change Order audits as high priority contingencies if scheduling allows the addition of more audits during the fiscal year.

Committee Member McCullagh made a motion to accept recommending to the City Council the approval of the proposed Audit Plan with the addition of the two contingency items. Committee Member Ecton seconded the motion, which was approved by a unanimous vote of three (3) to zero (0).

8. Discussion and consideration of regular Committee meeting days and times

Mr. Stockwell said it would be helpful for staff to have a standing meeting time set. He recommended scheduling all regular Audit Committee meetings on the fourth Monday of each month at 3:00 p.m.

The Committee agreed to that recommendation.

PUBLIC COMMENTS - None

ADJOURNMENT

With no further business to discuss, the Audit Committee meeting adjourned at 5:09 p.m.